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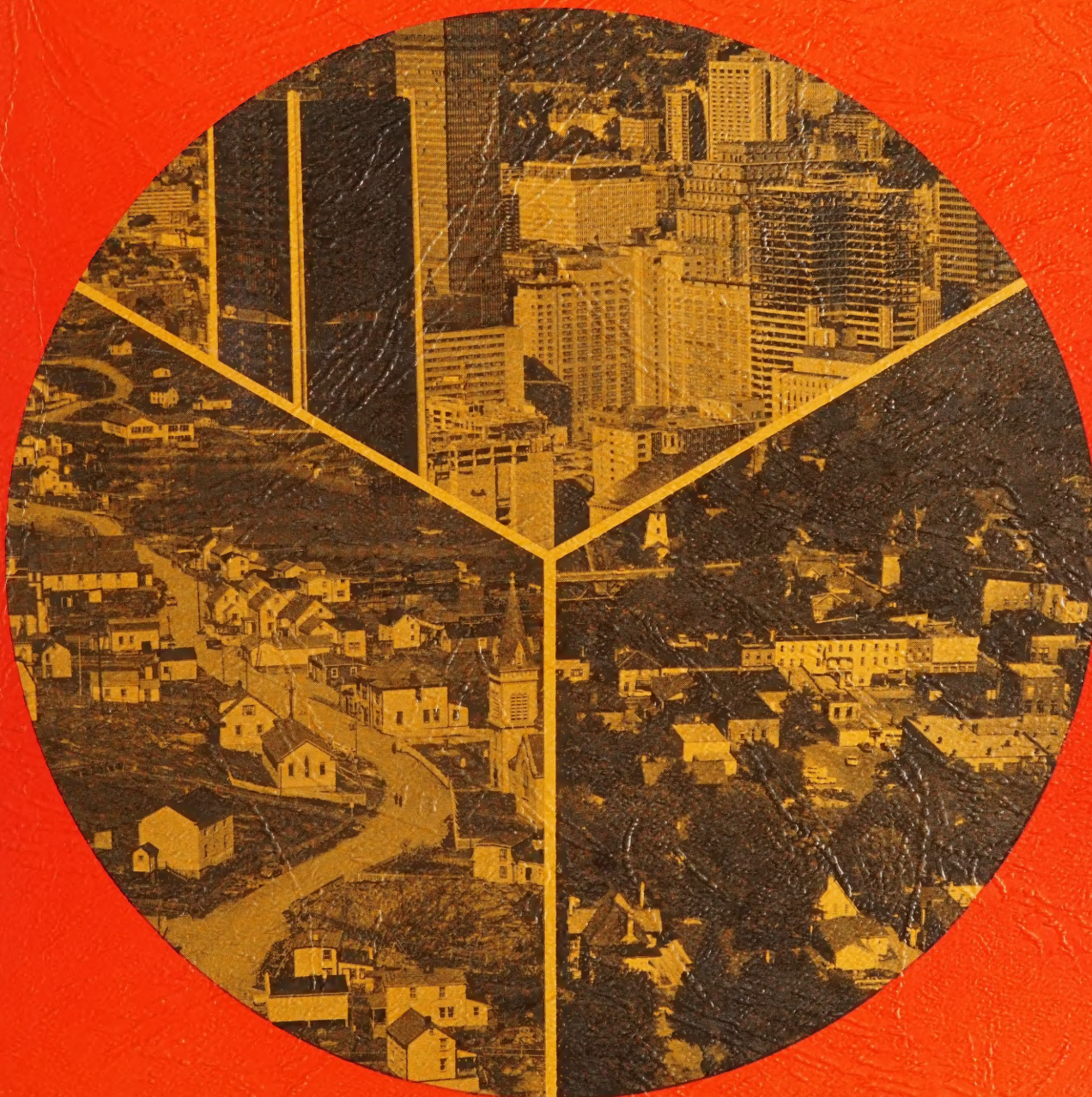
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A Financial Information System for Municipalities

VOLUME I — GENERAL INTRODUCTION



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A FINANCIAL INFORMATION SYSTEM FOR MUNICIPALITIES

VOLUME I

GENERAL INTRODUCTION

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FOREWORD

This publication marks the culmination of the work of the Eighth Federal-Provincial Conference on Municipal Finance Statistics. Its prime purpose is to set forth, for all municipal governments in Canada, their special funds and agencies, a Master Plan for the consistent classification of financial transactions in varying degrees of detail and on a basis compatible with the concepts and classification frameworks developed and under development for use by the Government of Canada and by the Provincial and Territorial Governments.

The aim of this blue-print is the standardization of the content of financial record-systems of municipal governments, irrespective of particular accounting practices used. Such standardization is essential to ensure that information required, not only for internal management purposes but also for analyses of local, regional, provincial and national scope, is available in forms which are consistent and comparable amongst governments.

Clearly, the potential merits of this Master Plan, which range from (a) improving communications among municipal governments by enabling them to discuss their common financial problems in a standard financial language to (b) a more reliable measurement of the Gross National Product, lie in the application of the principles and concepts and frameworks set forth in this document. It is hoped that Departments of Municipal Affairs will recommend, to the extent

applicable, the early adoption by their municipal organizations of the schema which follows as an integral part of an overall information system on financial transactions of governments in Canada.

The contribution made by federal, provincial and territorial government officials, particularly those provincial and territorial delegates who represented their Departments of Municipal Affairs at the Eighth Federal-Provincial Conference on Municipal Finance Statistics, is gratefully acknowledged (see list of Conference participants on next page). Without their help the preparation of this document would have been indeed difficult, if not impossible.

Special acknowledgement is made of the major contribution of the representatives from the Province of Quebec who arranged for the translation of this document into the French language.

The work done by Mr. J.B. Smith, Director, Governments Division, his predecessor Mr. W.B. Bolton, and Mr. A.G. Kerr, Chief, Local Government Section, is also recognized not only for their effective participation during Conference Sessions and the many hours spent in consultation with delegates between sessions, but also for the development of the basic material appearing in the various volumes that describe this Financial Information System.

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PREFACE

The introductory material which follows is organized in three parts. The first is designed to provide the reader with background information on the sequence of events and considerations which contributed to the production of this document. The second describes the kinds of municipal financial information required by those who use such information. The third part defines and describes some of the major concepts which were germane to the work of the Eighth Federal-Provincial Conference on Municipal Finance Statistics and are relevant in the interpretation and implementation of the conference's recommendations which formed the basis for this publication. Together these three parts comprise Volume I of *A Financial Information System for Municipalities*. Volume II comprises the various systems

for classifying financial transactions and the explanations relevant thereto.

It should be noted that, while these classification systems may have applications for other local governments, they are specifically designed for municipal governments.

Each paragraph is numbered for ease of identification; thus, Volume I comprises Paragraphs 101 to 500 and Volume II Paragraphs 501 to 6000. Interruptions in the consecutive numbering of paragraphs indicate a change of topic; the unused paragraph numbers are reserved for additional material as and when this becomes necessary.



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PART I

Background

- 101 The need to construct a framework for the consistent and comparable classification of financial transactions of local governments arises from the requirements of individuals, groups and organisations engaged in making decisions and advising on policies and practices affecting economic and social structures of local, regional, provincial/territorial and national consequence.
- 102 The development of activities at the local government level in Canada since the end of the Second World War has been very substantial. This growth, in both absolute and relative terms, has resulted in increased demands not only for more information about local government, but also for information of better quality, wider variety and on a more timely basis.
- 103 To assess these information requirements, to make them known to the suppliers of the raw data, and to acquaint the users of local government financial information with the problems of meeting many of their current and potential requirements, the Dominion Bureau of Statistics, jointly with the Institute of Local Government of Queen's University, the Canadian Tax Foundation and the Canadian Council on Urban and Regional Research, sponsored a conference on municipal statistics at Queen's University in 1966.
- 104 This Conference, which became known as "The Queen's Conference", among other accomplishments recommended the establishment of a Federal-Provincial Conference to undertake a major and essential revision of the *Municipal Finance Reporting Manual* (DBS Catalogue No's. 12-507 and 12-507F, 1960), which was the product of the Sixth (1953) and Seventh (1958) Dominion-Provincial Conferences on Municipal Statistics.¹
- 105 The Eighth Federal-Provincial Conference on Municipal Finance Statistics, under the sponsorship of the Dominion Bureau of Statistics, convened at Victoria, in April, 1967, on the invitation of the Department of Municipal Affairs of British Columbia. Delegates to the opening and subsequent Sessions of the Conference have represented the Departments of Municipal Affairs of all provinces and territories, the Dominion Bureau of Statistics, the Quebec Bureau of Statistics, the Ontario Statistical Centre, the Departments of Finance of Canada, Ontario and Manitoba and the Bank of Canada.
- 106 The meeting in Victoria laid down preliminary terms of reference respecting the proposed revision of the *Municipal Finance Reporting Manual* and agreed that:
- (1) DBS prepare recommendations on the form and content of a new manual for approval by the Conference;
 - (2) the work be undertaken in parts, and that each part be published as deliberations thereon are completed;
 - (3) publication be in loose leaf form to permit easy amendment as required; and
 - (4) the Conference remain in being until the project is completed.
- 107 Subsequent sessions were held at the invitation of the respective Provincial Departments of Municipal Affairs in Toronto and Fredericton in 1968 and in Winnipeg, Toronto and Halifax in 1969. The Sixth (Halifax) Session resolved unanimously "that the classification systems – of revenue by type, expenditure by function and by object (including own-account construction), assets, liabilities and equity by type – contained in the Supplement to the Report of the Fifth Session of the Eighth Federal-Provincial Conference on Municipal Finance Statistics and amendments thereto made at and proposed by the Sixth Session of this Conference, be adopted as the standard classification systems for municipal governments for publication by the Dominion Bureau of Statistics, subject to such minor editing as the Bureau may deem necessary in the interests of general uniformity and clarity." This Session also decided that publication of a new manual, reflecting the work accomplished by the first six sessions, should commence. The seventh and final session, which was held in Quebec in June, 1970, reviewed the manuscript of Volumes I and II of this publication.
- 108 Early in its deliberations the Eighth Conference became convinced that a mere revision of the 1960 edition of the *Municipal Finance Reporting Manual* would not render this Manual adequate for current requirements. This conviction arose from a number of considerations of which the principal one was that required information must be recorded in a way that permits relatively easy retrieval. Faced with the multiplicity of accounting systems employed by the thousands of units of local government, the Conference agreed that the prescription of standard reporting formats as in the 1960 Manual, would be an inadequate solution, and that the next apparently logical step, the design of a standard accounting system for all local governments, was not only beyond its terms of reference but also an impracticable approach.
-
- ¹ A review of the Queen's Conference and of the seven Dominion-Provincial Conferences on Municipal Statistics held in the period 1937 to 1958 is available in the DBS publication entitled *A Review of Conferences on Municipal Finance Statistics* (DBS Catalogue No. 68-505 March, 1967).

109 Further consideration showed that the most fruitful approach lay in the design of classification systems which would identify the items basic to meeting information requirements. These basic items would provide information "building blocks" which could be incorporated into existing accounting systems. However, the Conference decided that the design of new reporting formats would also be useful to demonstrate the desirable characteristics of financial statements and for use in instances where a supervising agency, e.g., a Department of Municipal Affairs, might not wish to prescribe such formats.²

110 In planning its approach toward a suitable set of classification systems, the Conference took into consideration the growing use of electronic data processing equipment for financial accounting purposes. It agreed that the proposed systems should be designed to meet a high degree of actual and potential information requirements where EDP equipment was employed, but that, at the same time, the systems should lend themselves to manual or "accounting machine" input and retrieval procedures.

² These reporting formats are contained in the supplement to Volume II.

111 The Conference also realized that, while the implementation of the standard classification systems would produce compatible information throughout a major part of the local government universe³ and that this information would be compatible with that obtainable in respect of the other levels of government, these systems would not in themselves necessarily provide for absolute comparability of information. Clearly, fair and reasonable comparisons of governments involve not only dollar amounts but also, for example in the case of expenditures, information on the type, quality and quantity of services provided. The Dominion Bureau of Statistics, in consequence, intends to work towards the development of performance indicators to measure levels of services provided by local government and the effectiveness and efficiency of local government in the provision of services.

112 The foregoing outlines briefly the considerations and the mechanics which led to the development of the detailed classification systems outlined in Volume II. However, the aspect of "user requirements", which, in effect, constitutes the principal reason for the development of the systems and for their implementation, would seem to require further elaboration.

³ See "Local Government" in Part IIB, of this volume.

PART II

User Requirements

- 151 User requirements for information on local government financial transactions range from that on individual transactions, as required by a local government official in the course of his normal duties, to aggregations into a few major categories of all data for all governments in Canada, as required by analysts studying the economy of the country as a whole. Between the raw data of a single segment of a local government and the major categories of financial information for the entire government sector lie successive aggregations of data which meet the requirements of the other users.
- 152 These intermediate aggregations are made partly by users, who then supply their aggregations to further users, and partly by specialized agencies, such as the Dominion Bureau of Statistics, the Quebec Bureau of Statistics, and the Departments of Municipal Affairs. One of the most important links in this input-output chain of information aggregation comprises those officials in local governments who are responsible for accounting and financial reporting. This importance arises from the fact that they make the first aggregations of information for which the input is not normally available to subsequent users; in consequence the utility and quality of all subsequent aggregations depends upon the work of these officials.
- 153 It is not possible here to describe all the aggregations of information which are made after these initial compilations of individual local governments, nor the uses to which these aggregations are put. The descriptions of certain major aggregations which follow are provided in order that local government officials may gain a better understanding of the statistical importance of their particular domains and a better appreciation of how their own particular operations fit into the broader mosaic of public finance in Canada.
- 154 Current Canadian economic analyses which incorporate local government data embrace three principal compilations. These are:
- (1) the quarterly estimates of national income and expenditure;
 - (2) the quarterly estimates of national financial flow accounts; and
 - (3) the Input-Output analyses.
- 155 The National Income and Expenditure series, which measures quarterly the estimated value of national output, is one of the prime tools for assessing the economic status of the nation. It measures the current pace and direction of national production in relation to past performance. It is a major indicator of economic activity. It distinguishes between volume and value output; as such, it is a guide toward policies required to ensure national growth and stability.
- 156 For the purposes of the National Income and Expenditure component of the System of National Accounts the whole of the economy is divided into four sectors: the "Personal sector", the "Public sector", the "Business sector" and the "Rest of the World". Local government expenditure on goods and services in 1969 is estimated at \$6.8 billion or about 8.8 per cent of total national expenditure on these items; local government expenditure in this area exceeds that of either the federal or provincial governments. The importance of adequate data on local governments for National Accounts Income and Expenditure compilations is thus apparent.
- 157 In the past the prime users of the National Income and Expenditure series have been the Federal Government, its agencies such as the Bank of Canada and the Economic Council, some provincial governments and a few private analysts especially in the academic field. However, there is a rapidly growing interest in this type of measure on a provincial basis and several provinces are considering the development of provincial equivalents. In addition, there is a growing number of business organizations which is becoming more aware of the value of the National Income and Expenditure statistical series as a guide to business investment and production policies. A number of current weaknesses in this tool result from inadequate and incomplete data. The proposed Economic Object Classification System is designed to cope with many of the current deficiencies.⁴
- 158 The Financial Flow Accounts, which are constructed quarterly for 32 subsectors of the economy, provide for analysis, on a national basis, of the movements of financial claims. Local governments and local government enterprises are two of the subsectors. Through the measurement of changes in categories of financial claims and of the net borrowing or lending positions of individual subsectors of the economy, a wealth of information is obtained on financial capital movements. Like the above described income and expenditure series, the Financial Flow Accounts are a tool of economic analysis. This tool aids in the assessment of borrowing or lending pressures; it assists in money supply and in cash flows management; it
-
- ⁴ For further readings on the National Income and Expenditure series see the DBS publications *National Income and Expenditure Accounts, 1926 - 1968* and the annual (Catalogue No. 13-201) and quarterly (Catalogue No. 13-001) publications; see also *A System of National Accounts* (United Nations Statistical Office, 1968).

isolates where savings are generated and how they are deployed.⁵

159 The whole system of the National Financial Flow Accounts is in the relatively early stages of development; two of the weakest subsectors at present are those of local governments and local government enterprises. Through the adoption of the proposed Asset and Liability Classification Systems and with some improvement in reporting practices, the reliability of the analysis within these subsectors can be greatly improved.

160 **The Input-Output Tables of the System of National Accounts** describe the production, expenditure, and international trade of the economy. They are based on the observation that production in modern technological societies is akin to a chain-reaction process with the final output — the finished product — being the last link in a chain which stretches back, frequently through many different industries, to the raw material. At each stage or link in the chain the output of the previous stage becomes input to be further processed into a new output which, in turn, becomes input to the succeeding stage. The value of the Input-Output Tables lies in their presentation of the origin and disposition of individual groups of commodities and of the cost structures of individual industries. The tables are closely linked to the National Income and Expenditure Accounts. Further, the Input-Output tables provide the essential basis for the construction of sectional models of the workings of the economy.⁶

161 The Input-Output tables are at a relatively early stage of development and the full impact of their information requirements on government lies in the future. It can be seen, however, that these requirements will include detailed information on inputs to government through the development of the Object Classification System and a parallel development on outputs involving the establishment of links between the activities of government and the Standard Industrial Classification System, probably through the Functional Classification System. The early adoption of the Object Classification System described in Volume II of this publication is a most important first step.

162 Though the impact on local government of the information requirements of the other economic series which complete the System of National Accounts is either less than that of the Income and Expenditure and Financial Flows Accounts or, like that of the Input-Output tables, lies mainly in the future, mention

of these other series is appropriate here. **The Balance of International Payments** data, the longest established component of the System, requires information on local government financial transactions involving foreign currencies, particularly investments and borrowings outside Canada. At present the **Indexes of Real Domestic Product by Industry** and the **Productivity Studies** have barely touched the public sector; however the balance sheet (wealth) estimates, now under development, will require considerable information from local governments.

163 In addition to the major economic series, there is a second national series of financial statistics. These embrace revenue, expenditure, asset and liability analyses and specialized sub-analyses (such as capital investment and salaries and employment) of the kind of data generally incorporated in financial statements of local governments and the annual reports of provincial departments such as Municipal Affairs; typical examples of these analyses are the quarterly, semi-annual and annual publications of the Dominion Bureau of Statistics in what is known as the **"Financial Management Series"**. These series are designed to provide for the in-depth study of government itself, i.e., its organisation, the services it provides and how it raises revenues. They also constitute the bases for detailed study of particular programs and policies and provide valuable information for related financial planning.

164 The above discussion of the ways in which user requirements for financial information are met has concentrated on the national scene and has looked at local government officials mainly as suppliers of data. However, the same data used to compile the national aggregations is also used by local governments in their day-to-day administration. Before developing this proposition it is useful to consider the present condition of all governments in Canada.

165 A local government today does not and cannot exist in isolation; it is dependent on other local governments and on the federal and provincial governments. There is, in fact, a growing interdependence of all governments which is best seen in the increasing number of major programs that are no longer confined to any one level of government but involve increasing participation by two or all three levels of government. This growing interdependence of governments is matched by a growing scarcity of financial resources for governments; paralleling these developments is the growth of government in terms not only of size but also of impact on the Canadian economy and on Canadian society.

166 Increasingly, therefore, governments are faced with more and more crucial decisions, collectively on the allocation of programs and resources among themselves and individually on the allocation of resources among programs. Good information does not necessari-

⁵ For further readings on the Financial Flow Accounts see *Financial Flow Accounts, 1962-67* (DBS Catalogue No. 13-530) and the quarterly and annual publications (Catalogue No. 13-002).

⁶ Further information on the Input-Output Tables is contained in the two volumes *The Input-Output Structure of the Canadian Economy, 1961* (DBS Catalogue No's. 15-501 and 15-502, 1969).

ly result in good decisions but poor information makes the reaching of good decisions much more difficult. Financial information by itself is not enough for good decision making but good financial information is an essential prerequisite for this. One inevitable conclusion to be drawn from the foregoing two paragraphs is that the demands for financial information by and from local governments are now very large and are likely to grow much larger in future. The classification systems described in detail in Volume II have been designed specifically to provide the kind of information that is now required by the financial officials of a municipal government and of its self-accounting ancillary organizations, by its governing body, by the provincial and territorial governments, by the public, and by non-governmental users as well as that required for national purposes.

167 Local government in Canada exists to provide services which the provincial or territorial government deems are best provided by entities with jurisdiction over defined geographical areas within the province or territory.⁷ Normally the operations of a local government take the form of an annual cycle of planning, implementing, and of assessing results. The financial side of this cycle consists of budgeting, recording, controlling, and interim and final reporting. Since the recording of raw financial data is the necessary preliminary to budgeting and reporting and is the basis for controlling, the requirements of these latter operations will determine the method of recording. The brief explanation which follows shows how data, recorded in accordance with the Classification Systems, described briefly in Part II of this volume and in detail in Volume II, will meet the requirements of municipal government budgeting, controlling and reporting.

168 Municipal government budgeting can be viewed as the processes of determining what services are to be provided and at what levels, what costs this provision of services entails, and how the monies necessary to meet these costs are to be raised. These processes, of course, are concurrent rather than consecutive.

169 **The Functional Classification System of Expenditures** identifies all the known services provided by Canadian municipal governments. Use of the system, therefore, enables a municipal government to identify and describe the services it provides in terms which are standard for all such governments and are compatible with those used by, or under development for, other levels of government.

170 A municipal government provides services by using its own staff, hiring outside organisations, purchasing or renting goods, and by transferring monies to people and organisations who are thereby enabled to

provide themselves with the desired services. In other words, a municipal government discharges its functions by expending money on the purchase of goods and services (of people and organizations) and/or by transferring money to people and organisations. These, in the language of the economist, are the primary "objects" of expenditure. **The Object Classification System of Expenditures** breaks down these primary objects into successive levels of increasing detail. This system, therefore, parallels the Functional Classification System, which describes expenditures in terms of services provided. Use of the Object Classification System enables a municipal government to achieve comparability and compatibility with other governments in identifying and describing the expenditures it makes to provide services.

171 In the same way that the Functional and Object Classification Systems of Expenditures provide standard methods by which a municipal government can identify and describe the services it intends to provide and estimate their costs, the **Revenue Classification System** provides a standard approach to the identification and description of the mix of taxes, other imposts, service charges and other revenue raised directly by the government, and the transfers (grants) available from other governments. Finally, the lending or borrowing undertaken by a municipal government can be identified and described in a standard manner by reference to parts of the **Asset and Liability and Equity Classification Systems**.

172 The adoption of the Classification Systems for the budgeting and recording parts of the annual financial cycle of operations results in the generation of financial information in forms which are easily adapted to meet many of the controlling and reporting requirements of municipal governments and Departments of Municipal Affairs. Further explanation of these latter requirements is given in Section G of Part II of this volume.

173 However, it is emphasized that the Classification Systems are general in nature; they are not designed specifically for control purposes since the systems of financial and administrative control used by municipal governments are too idiosyncratic to be described by a single generalized system. That part of the control operation which is typified by fund accounting presents no obstacle to the adoption of the Classification Systems since the relevant classifications can be adopted in each fund. Some administrative structures may present problems in the implementation of the Classification Systems; for example, the operations of a "department" may now be distributed among several functions. It is worth noting that experience in pilot projects shows that administrative structures can be aligned to conform with the functions of the Functional Classification System without major dislocations in operations and with obvious advantages in simplification of information processing and reporting.

⁷ For a description of the organisation of local government see Part IIB following.

174 It is not anticipated that all municipal governments will include in their accounting systems the full detail set forth in the classifications. Indeed for many central bodies and for even more subsidiary organizations, sections of the classification systems will be totally irrelevant. In other instances, the classification systems provide for detail which is unnecessary for the operations of small units and unreasonable to expect of them; conversely, in large organizations additional detail may be desirable or even mandatory. Guidelines

on the amount of detail necessary for meeting national requirements for information, as viewed by the Dominion Bureau of Statistics, are suggested in general terms in Section G, "Records and reports", of this volume and in the proforma statements contained in the supplement to Volume II. These guidelines must, of course, be interpreted in the light of mandatory requirements of provincial and territorial governments and of the internal needs of individual municipal governments.

PART III

Concepts

Section A. Introduction

201 The number of concepts embodied in a complete financial information system for local governments is very large; initially, however, this part is confined to an examination of six major premises which are basic to the proper understanding and implementation of the recommendations contained in Volume II.

202 In Section B the structure of local government in Canada to-day is delineated in terms of broad groupings of the individual entities to which this publication is addressed. In Section C fund accounting is defined; explanations prepared by various provincial authorities of how this system of accounting applies to their municipal governments are given in Appendix A. In Section D fixed assets are defined and general recommendations for the treatment of transactions and accounts relative thereto are made. In Section E the classification systems are described in general terms as a preface to the detailed explanations in Volume II. In Section F the principal categories, into which all intergovernmental financial transactions are allocated in this publication, are described. Section G comprises a general discussion of records and reports.

Section B. Local Government

211 Government in Canada is composed of three levels—federal, provincial or territorial, and local. The provinces and territories have established local governments to discharge responsibilities, which rest within provincial and territorial jurisdiction, but which the provinces and territories believe are best administered by local bodies.

212 However, no clear cut pattern divides responsibilities between provincial/territorial government and local government; history, tradition, economic geography, and many other factors have played major roles, not only in the allocation of responsibilities to local government, but also in the way these responsibilities are discharged within each province and territory. Thus, the only simple definition of local government is all government entities below the provincial/territorial level which, by the terms of their establishment, do not form part of that level.

213 While both their responsibilities and structures are subject to continual change, local governments, as they exist today, can be assigned to three principal categories — municipalities, special purpose boards, and local school boards. **Municipalities**, in turn, may be of three kinds:

Unitary municipalities comprising cities, boroughs, towns, villages, townships, rural municipalities, districts and counties (in Nova Scotia and Alberta);

Regional municipalities, often called “second-tier” governments, comprising metropolitan corporations and municipalities, regional districts and municipalities, urban and regional communities, and counties (in Ontario and Quebec);

Quasi-municipalities, provincially-appointed boards or officials discharging municipal responsibilities in areas that would otherwise be considered unorganized territory, e.g., local government districts, local improvement districts and the like.

214 **Special Purpose Boards** are established by the provincial/territorial government usually to provide a specialized service to areas which embrace more than one municipality; examples are regional library boards and conservation authorities.

215 **School Boards** in some respects appear more as provincial/territorial government entities than local government organizations because of the controls exercised by the former governments over the quality and quantity of the service provided. However, because the activities of individual boards are confined to specific localities and because most school boards are supported by local taxation, they are generally considered to be a major component of local government.

216 Two other categories of local governments, **Joint Boards and Commissions** and **Municipal Boards and Commissions**, also exist, principally as adjuncts or subordinates to municipalities, though some similar organizations are being established by school boards. **Joint Boards and Commissions** are established by groups of municipalities to provide a particular service, e.g., fire protection, for the group. **Municipal Boards and Commissions** are established by individual municipalities usually to operate enterprises or institutions or to provide services which can be isolated from the general operations of the government,

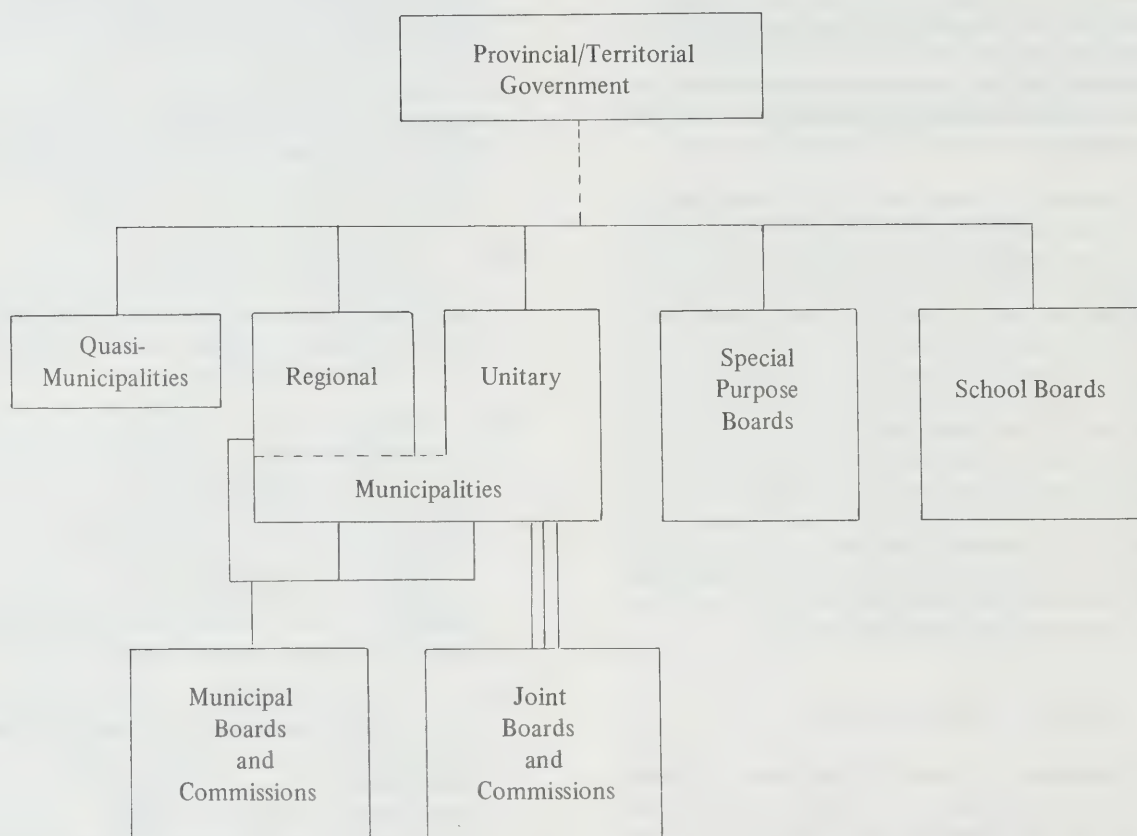
217 The accompanying diagram displays a simplified scheme of the organization of Canadian local government.

Section C. Fund Accounting

221 A **Fund** is a separate accounting entity established to segregate, within the accounting system of an organization, those transactions recording the acquisition or disposal of financial resources which the organization is required, or desires, to devote solely to a particular activity or towards a particular objective.

222 **Fund accounting** comprises those accounting procedures in which a self-balancing group of accounts — cash and/or other resources, all related liabilities, obligations, reserves and other equities — is provided for each independent fiscal and accounting entity established by legal, contractual, or voluntary action to carry on specific activities or to attain certain objectives, especially in governmental units.

THE STRUCTURE OF LOCAL GOVERNMENT IN CANADA



223 The statutes and supporting regulations establishing municipal governments and specifying their powers contain many accounting requirements. These requirements arise from the restraints which the provincial/territorial governments consider essential to impose in respect of the uses to which municipal governments may put the financial resources made available to them. Because fund accounting is suitable for the verification of compliance with legal requirements, it is prescribed, or recommended, by provincial and territorial authorities for many municipal governments in Canada.

224 The extent to which fund accounting is prescribed in each province and territory is shown in the Appendix.

225 In addition to prescribed or mandatory funds, or to funds arising from contractual obligations such as sinking funds relative to certain forms of indebtedness, some municipal governments voluntarily establish funds, again usually for control purposes, to isolate the financial transactions relating to certain of their activities,

particularly when control over these activities is delegated to boards or commissions.

226 While the design of accounting systems is beyond the scope of this publication, there are a number of misconceptions about fund accounting; attention is drawn to two in particular.

(a) There is no necessary direct relationship between the funds used by a municipal government and its bank accounts. While the legal provisions governing certain funds may require separate bank accounts for these funds, in general a fund may have as many bank accounts as desired or, alternatively, a number of funds may be combined in a single bank account.

(b) Fund accounting is not the only system by which legal and effective control over the handling of monies can be secured. Since fund accounting is fragmentative by nature, the proliferation of funds can produce a system which is complicated to operate and which may make it difficult for the governing body to maintain a comprehensive overview of the activities it directs. It is recommended

that separate funds should be restricted to those which are mandatory or administratively essential.

Section D. Fixed Assets

231 Assets of a fixed or permanent nature are described by a variety of terms of which the commonest are “fixed assets”, “capital assets”, and “assets of a capital nature”. Such an asset is defined as a durable, tangible, physical thing of value owned, including additions, replacements, and major alterations thereto, from which a stream of benefits is derived over a period of years. In this publication, such an asset is termed a “fixed asset”. However, there are certain items, particularly tools and parts, which display the above listed characteristics of a fixed asset but which, because of their relatively large numbers and low individual values, are more conveniently classified as consumable goods. Reference to the Object Classification System in Volume II will show the treatment to be accorded to such items. One of the most important characteristics of a fixed asset is its ability to serve as a generator for the output of goods or services. It is essential, therefore, for the charting of economic development and the planning of future growth that all transactions relating to the acquisition, disposal, modification, repair and maintenance of fixed assets be identified. In addition, those transactions which affect the national stock of fixed capital – the acquisition of new fixed assets or of imported new or used fixed assets, or modifications which increase the productivity of existing fixed assets, and which, collectively, are termed fixed capital formation – should be separately identified.

232 In identifying transactions relating to fixed assets, a problem arises in differentiating between repair and maintenance. The essential differences between the two are easily defined; repair is undertaken to ensure that a fixed asset will provide throughout its expected life the service for which it was originally required, while maintenance is designed to keep the asset at normal day-to-day operating efficiency. In practice, the two have no clear dividing line, particularly because both are frequently undertaken jointly or maintenance develops almost imperceptibly into repairs. However, since repair is conceived as involving the same inputs to a fixed asset as were employed in its original construction, whereas maintenance is not, every effort should be made to separate the two in the interests of identifying the “industrial” transactions of municipal government.⁸

⁸ The concept of governments as conglomerates of the “industry” of government and of other industries is developed in the DBS publications on the *Standard Industrial Classification System* (Catalogue Nos. 12-501 and 12-501F).

233 A different kind of difficulty arises over the methods to be used for valuing fixed assets in the records of local governments and whether or not such recorded values should be subject to charges for capital consumption, i.e., what is loosely called “depreciation”. The fixed assets of a government can be valued in many ways – historic cost, appraised value, replacement value, at the amount of related unredeemed debt, or at nominal or nil values. Valid arguments exist for each method. The historic cost method, by which assets are valued at their original costs plus the costs of repairs and modifications, provides a convenient form of perpetual inventory. Valuation at the amount of unredeemed related debt is most convenient for the purposes of balance sheet accounting. Nominal or nil value acknowledges the extreme difficulty of assigning meaningful monetary values to long-life fixed assets owned by governments, such as buildings, roads, sewers, water systems and the like.

234 No particular method of valuation of fixed assets is recommended at present; the technical details for reflecting the principal methods in use are shown in the chapter on asset classifications in Volume II. However, the reference above to charges for capital consumption emphasizes that recommendations on the valuation of fixed assets may be introduced in the future.

235 It has been almost axiomatic for many years that many governments do not formally include charges for “depreciation” in their accounts except in cases where a particular activity of a government is purely commercial in nature and commercial type accounting is employed, or where there is a need to measure certain activities, e.g., the use of machinery and certain types of equipment, against related commercial activities. While many reasons have been advanced for this abstention from “depreciation” by governments, the most cogent argue that “depreciation” generally serves no useful purpose in governmental accounting, except in the cases mentioned above.

236 The probable development of performance indicators and the wish to promote true comparability between governments on the one hand, and to include consumption of fixed capital by governments in the National Accounts on the other, inject new elements into the accounting treatment of fixed assets. Governments do consume fixed capital in providing services and this consumption should be accounted for; it is only the difficulty of measuring this consumption in a useful and generally acceptable manner that remains to be solved.

237 For the present, municipal governments should follow the methods of fixed asset valuation prescribed by their provincial or territorial governments. “Depreciation” should be used only in commercial-like activities where it is necessary or useful.

Section E. The Classification Systems

General

241 Classification consists of ordering things in groups which have been previously determined in accordance with relevant concepts. Besides producing order, classification confers other benefits. Rigorous application of a standard system of classification ensures that the same things are always assigned to a particular group; thus comparability of data between applications of the system is achieved. Further, this grouping is essential if manipulation of large numbers of things is to be feasible. It is to secure these benefits that the approach to a financial information system for municipal governments described in this publication is based on the classification of individual transactions rather than on the allocation of previously aggregated transactions to categories arranged to fit financial statements.

242 The complexity of the classification systems described in detail in Volume II results from the many different types of information that are required about the financial transactions of municipal government. This complexity should not mask the innate simplicity of the systems. Each system consists of a series of levels each of which amplifies the information classified in the next higher level; in this way each system proceeds from a number of broad categories towards ever finer detail within each category.

243 In earlier DBS manuals only the principal classifications and their main components were displayed in tabular form, usually in pro-forma statements. Typical sub-components were enumerated in the accompanying text. In this publication the detail classification systems replace these enumerations. As has already been stated above, **it is most important that the publication of these detailed systems be not misconstrued as an implication that all the systems must be adopted in full by all municipal governments.** Quite apart from the fact that many of the classifications do not apply to the transactions of a particular government, the amount of detail shown in a particular classification may far exceed that required by or from that government. In such cases the details shown should be looked upon as guides for the classification of particular items. Conversely, in the case of large complex organizations even greater detail than that shown may be required for internal administrative purposes.

244 Expansion of the system to provide finer details than those identified in the classifications in Volume II can be accomplished at the option of any government providing that the basic pyramidal nature of the system is retained as in the following example. The published system identifies revenue from building permits at the third level (Code 1.5.1.7.0). To identify

whether a permit covered a new building or renovation of an existing structure, what kind of building was involved, and the particular building activity covered by the permit, the system may be expanded as follows:

1.5.1.7.0.0.0	Building permits
1.5.1.7.1.0.0	New construction
1.5.1.7.1.1.0	Single family dwelling
1.5.1.7.1.1.1	Excavation
1.5.1.7.1.1.2	Erection
1.5.1.7.1.1.3	Electrical
1.5.1.7.1.1.4	Plumbing
1.5.1.7.1.1.5	Heating and air conditioning
1.5.1.7.1.1.6	Elevators and escalators
1.5.1.7.1.1.7	External fabric cleaning and repairs
1.5.1.7.1.1.8	Internal repairs
1.5.1.7.1.1.9	Other
1.5.1.7.1.2.0	Multi family dwelling
1.5.1.7.1.2.1-9	Excavation, etc. as above
1.5.1.7.1.3.0	Apartment
1.5.1.7.1.3.1-9	Excavation, etc.
1.5.1.7.1.4.0	Office building
1.5.1.7.1.5.0	Retail store
1.5.1.7.1.6.0	Other commercial building
1.5.1.7.1.7.0	Industrial building
1.5.1.7.1.9.0	Other
1.5.1.7.2.0.0	Renovation

Notes:

- (1) For each type of building the subsidiary classifications "Excavation" etc. are repeated.
- (2) For the classification "Renovation" the complete sub-system shown for "New construction" is repeated.

245 Included in each system are classifications for transactions which are not strictly part of the particular system; for example, the Revenue Classification System includes certain items which are receipts rather than revenue, such as the items classified under "Other transfers, collections for other governments" (Code 1.9.0.0.0.). These and similar "non-expenditure", "non-asset" and "non-liability" items are included to ensure that the Classification Systems embrace all financial transactions rather than only those which, in accordance with strict accounting concepts, should form part of the particular Classification System.

246 The purposes for which the Classification Systems have been constructed are described in broad outlines in Paragraphs 112 to 134.

The Revenue Classification System

251 "Revenue" is defined by accountants as the gross amounts received, and receivable which do not increase any liability or reserve, do not represent the refund of an expenditure, but are available to meet expenditures. All amounts due within a given fiscal period are termed "current revenue"; amounts received in advance of the

fiscal period in which they are due are termed "deferred revenue", while amounts recorded in anticipation of and in advance of receipt are termed "accrued revenue".

252 The basic structure of the Revenue Classification System described in detail in Volume II provides for the allocation of all amounts received by a municipal government (and government here includes all its funds and agencies) into three main categories, viz.:

- (1) amounts acquired through the exercise of its power to raise revenue by taxes and other impositions, either directly or through other governments;
- (2) amounts transferred to it from other governments and their agencies;
- (3) amounts transferred between funds and/or agencies, and amounts collected directly or indirectly for other local governments.

253 The first of these categories identifies revenue, the ultimate or final expenditure of which is under the control of the municipal government concerned. In the other category, control rests with the provincial/territorial government or the federal government and or, occasionally, on tradition. Amounts transferred are dependent on agreement, on legal provisions, or, occasionally, on tradition. Amounts transferred by other governments to a municipal government as payments in lieu of taxes (where a municipal government is prohibited from levying taxes against the other governments) are included in the first of these two main categories because of their relationship with taxes.

254 The third main category encompasses items which are not "revenue" as defined in Paragraph 251 above. Thus monies, constituting revenue of one fund or agency of a municipal government, which are transferred, for ultimate disposition, to another fund or agency of the same government, do not constitute revenue of the receiving fund or agency but are transfer receipts. (Such monies are not expenditures of the transferring fund or agency but transfer disbursements.)

255 Conversely, amounts collected by a municipal government specifically for ultimate disposal by another government are regarded as revenue of the second but not of the first government. This concept reverses the practice recommended in the **Municipal Finance Reporting Manual** (1960 Edition) under which amounts collected for and transmitted to other bodies were included in the revenue and expenditure of the collecting government. Clearly, such amounts are not available to meet the expenditures made by the collecting government on its own operations and, since they increase a liability of the collecting government, they do not conform with the definition of revenue in Paragraph 251. Problems in the application of this

concept are discussed in Paragraphs 307 and 308 of this volume.

256 The need to portray the activities of an individual government accurately and, at the same time, to disclose in detail its financial relationships with all other governments requires that intergovernmental financial transactions be identified in considerable detail as the Classification System shows. Further general information on the kind of information required in this connection is given in Section F "Intergovernmental financial transactions".

257 Revenues should be recorded and reported in gross amounts at all times and the practice of netting such items as "recoverable expenditures", as formerly recommended in DBS manuals, should be avoided. Fuller information on the underlying reasons for these recommendations and on their general implications is given in Section G.

Expenditure - General

261 An "expenditure" is defined as an outlay made, or a liability incurred, to obtain, or to assist another to obtain, a good or a service. The outlay need not take the form of a cash payment, which is called a "disbursement", but may be in the form of barter or transfer of property, rights, or the like. An "expense" is not necessarily synonymous with an "expenditure". An "expense" is that (portion of an) expenditure which is "assignable" only to current revenues or incurred only in the current fiscal period. An "expenditure" can be an "expense" of the same fiscal period in which it is incurred and/or of a future period or periods.

262 While there are many ways of classifying expenditures, three are of primary importance and one of secondary significance for municipal governments. A municipal government will seek to identify its expenditures in terms of authorization therefor, purpose for which made, and goods and services thereby acquired. Increasingly it will also wish to know whether the expenditure was made to benefit the whole geographical area under its authority or a sub-area within that realm. The three primary types of grouping of expenditures are termed Classification by Responsibility Centre, Classification by Function, and Classification by Object. The secondary type is Classification by Geographic Sub-area.

263 The council, or governing body, of a municipal government will normally delegate part of its authority to make expenditures to sub-committees, departments, branches, divisions, sections and individual officials. Each of these sub-units or persons is termed a Responsibility Centre. To ensure control over these responsibility centres, all the expenditures of the municipal government must therefore be assigned to

the responsibility centre which authorized them. This may be accomplished through the use of an Administrative (Responsibility Centre) Classification System of Expenditures. This Classification System reflects the administrative organization and, since such organizations vary widely from government to government, no standard system can be recommended. However, the administrative organization is generally linked to the functions of a government; consequently re-alignment of the administrative organization to make it coincide with the functions and programs identified in the Functional Classification System is feasible. Such a re-alignment would eliminate the need for a separate Administrative Classification System and a significant simplification of records and reports would follow.

264 In Canada, the practice of describing government expenditures in terms of the functions on which the expenditures are made was developed through a series of Federal-Provincial Conferences, the first of which was held in 1933. This practice, which is formalized in the Functional Classification System of Expenditures, has many applications. By providing comparability of information on expenditures between governments at a given level and compatibility of such information with that from governments at other levels, the system allows for comprehensive studies of the roles of governments in terms of services they provide and the costs of those services. It is also the basis for Planning Programming Budgeting Systems and, potentially, for the measurement of government efficiency and effectiveness.

265 The rapid growth of the government sector of the economy in relation to the other sectors — persons, business, and the rest of the world — has led to an increasing demand for information on the economic resources governments consume in discharging their functions. Municipal governments have always required information, for management purposes, on their expenditures on such “economic objects” as salaries and wages, consumable goods, fixed assets, and transfers of monies to others. Although the need to provide this information from all local governments for the purposes of economic analyses has been recognized for many years, the difficulty of operating an Object Classification System effectively — that is, in parallel with classification by Responsibility Centre and by Function — has precluded its general introduction. However, the advent of the computer greatly facilitates the processing of information items which have multiple classification. The growing use of computers by municipal governments, therefore, now makes the introduction of a standardized Object Classification System of Expenditures opportune. While adoption of the full detail of the Object Classification System probably requires the use of a computer, the basic elements of the system, i.e., the Standard and Reporting Objects, can be incorporated in manual or mechanical systems.

266 The territory administered by each municipal government comprises a number of sub-areas which differ both by innate physical characteristics and by the type and level of development given to them. These differences are most important for planning and zoning purposes but a knowledge of the revenue potential and expenditure requirements of these sub-areas is also necessary for management and for many external users of municipal government finance information. While the only universal geographic classification system so far developed — Geocoding⁹ — is not completely satisfactory for municipal government purposes, much development work on the design of systems is under way. As these systems are developed they will be described in amendments to this publication.

Expenditure — The Functional Classification System

271 The Functional Classification System of Expenditure, which is described in detail in Volume II, provides for four levels of classification. At the primary level are the functions which describe very broadly the services provided by municipal government. Each function consists of a number of programs which relate the principal operations of government to the broad functions. Each program consists of a number of sub-programs which identify the main components of the program, and some sub-programs, in turn, are broken down into activities to provide additional detail or to assist in the classification of individual transactions.

272 While the present system is based on the principles used to establish earlier systems, such as that portrayed in the 1960 **Municipal Finance Reporting Manual**, current thinking has led to some significant changes in the concept of what constitutes a function. For instance, “Public works” is no longer classified as a single service but, rather, as a component of several functions to which “Public works” expenditures should be allocated. In addition, programs have been regrouped and there has been considerable re-arrangement of sub-programs and activities. These changes have been made to reflect recent changes in the ends towards which expenditures are made; for example, most present expenditures on street lighting are now aimed at improving facilities for road transport rather than protecting persons and property as in the past.

⁹ Geocoding. A system of assigning code numbers to all geographic locations within Canada. Briefly, the basis of the system lies in relating selected points within a geographic area to co-ordinates of the Universal Transverse Mercator Grid. (This is a grid system similar to that of Mercator but with the parallels of longitude always at right angles to those of latitude.) These selected points are usually block face centroids — a centroid being the centre point in one side of a city block. While geocoding, therefore, in its present form is a system for the national coding of street addresses — and this has many applications for municipal government — it does not recognize the streets, sidewalks, alleys, etc. which are very significant locations in the operations of municipal government.

273 The Functional Classification System of Expenditures identifies the services rendered by municipal governments in terms of six main functions, viz.

- Protective Services
- Transportation Services
- Environmental Health Services
- Public Health and Welfare Services
- Environmental Development Services
- Recreation and Community Services; Education

Two additional functions – General Government Services and Fiscal Services – describe the internal activities of municipal government while a ninth function – Other Services – is provided for activities not classified elsewhere.

Expenditure – The Object Classification System

281 An Object of Expenditure is that upon which money is spent. In contrast to the Functional Classification System, which reflects the type of service provided by a government, the Object Classification System indicates how a government provides those services, i.e. by the acquisition, or rental, of goods and of services (of people, business, and other governments) and by the transfer of monies to people, business, and other governments.

282 The Object Classification System as set out in Volume II is designed to serve the needs of municipal governments themselves as well as those of private, commercial, academic and government analysts of public finance statistics by providing a formally approved comprehensive national classification framework which permits comparability of data between individual governments and, consequently, comparable aggregations of data for groupings of governments. The Object Classification System parallels the Functional Classification System; however, while the latter can be said to depict the social impact of government expenditures, in terms of services provided by governments, the Object Classification System reveals the economic impact of those expenditures; it is, therefore, of prime importance in economic analyses.

283 Use of the Functional and Object Classification Systems in parallel permits the analysis of expenditures on a particular function or sub-division of a function in terms of the mix of objects used to provide the service under study. Conversely the distribution of expenditures on a particular object among the various functions discharged by a government is also revealed. Cross-classification of expenditures by function and object by demonstrating the cost structures of individual programs is a valuable tool in planning future operations and in determining the most efficient use of available financial resources.

284 The system under which objects of expenditure are classified is a method of describing municipal

government expenditures in terms of goods and services acquired and transfers of monies made. These are the primary objects but, since each primary object is too all-encompassing to be meaningful, the first level of identification within the system is that of the standard objects which relate to the primary objects as follows:

Primary object	Standard object
Services . . .	1. Personnel
	2. General services
	3. Government services for resale or general supply
	4. Government services for own account
Goods	5. Goods
	6. Fixed assets
Transfers . .	7. Transfer payments
	8. Financial charges
	9. Other transactions

285 While the full value to be derived from the system requires the use of the complete detail shown in the classification tables, it is recognized that local circumstances may require a lesser level of detail to be used as an interim measure towards full implementation of the system. Conversely, further levels of detail may be constructed, providing the usual many-to-one relationship is maintained with the levels described here.

Own Account Construction

291 In addition to purchasing fixed assets and to using the services of contractors to repair and maintain existing fixed assets, municipal governments use their own work forces to construct, repair and maintain fixed assets. These practices have many names; in this publication they are referred to as "Own account construction".

292 While the Object Classification System enables all expenditures relative to fixed assets to be identified when these expenditures cover purchases of completed fixed assets or purchased repair or maintenance thereof, it does not relate expenditures on Own Account Construction to the respective fixed assets. These latter expenditures are identified, for example, as the salaries and wages, etc. of the employees engaged in the work and materials and supplies used. While the relationship of Own Account Construction expenditures to the fixed assets involved can be established by manual procedures, such as scrutiny of work orders, establishing special subsidiary accounts, etc., it can be more easily accomplished by a supplementary coding system when automated data processing is used.

293 The Own Account Construction Coding System relates expenditures on goods (e.g. materials and parts) and services (e.g. salaries and wages of a government's

own employees) to the type of fixed asset in the construction, repair or maintenance of which a municipal government's own work force incorporated the designated goods. It thus identifies total own account expenditures on a particular fixed asset.

Asset, Liability and Equity Classifications

- 295 An "Asset" is defined as a thing of value owned. A "Liability" is an amount owed. "Equity" is the claim or right of proprietors to the assets of an entity. Together, accounts in these three categories are frequently referred to as "Balance Sheet Accounts" from the form of financial statements in which they are reported. However, the financial data incorporated in these accounts is also required for a variety of other purposes such as studies on, and reports of, the sources and applications of financial resources, financial flows, working capital, future requirements for debt repayment, and others.
- 296 The "things of value owned" by a municipal government consist either of tangibles or of claims either against others or against financial resources it expects to acquire in the future. Thus, the classification system of assets identifies the types of tangibles and of claims, and, in addition, the entities against which the claims exist.
- 297 Eight principal types of asset are described in the system. These are — cash, receivables, investments, loans and advances, tangible assets, debt charges receivable, other assets, and deficits. The system provides for two subsidiary levels of identification, each in turn, providing increasingly finer detail, and for a fourth level to identify other essential information such as the entity against which claims are held.
- 298 The Liability Classifications identify claims against the reporting government: as such, they are the counterparts of the Asset Classifications which relate to claims against others. The four main classifications of liabilities are short-term borrowings, payables, long-term debt, and other liabilities. A fifth major classification — asset valuation allowances — provides for the classification of deductions from the value of certain assets where the value on realization is expected to be less than the stated value.
- 299 The introduction of the term "Equity" into government balance sheet accounts represents a departure from previous practice which included such items in "Liabilities". A balance sheet is conceived as comprising Assets — that which is owned, Liabilities — that which is owed; and the difference. The term "Equity" was chosen in preference to "Other credits" to designate this difference between assets and liabilities.

Section F. Intergovernmental Financial Transactions

- 301 While this section describes financial transactions between local governments, or between such governments and the federal or provincial/territorial governments, the concepts outlined here apply, with appropriate modifications, to transactions between a single municipal government and its own funds and agencies.
- 302 A government rarely, if ever, operates in complete isolation from other governments at the same level or from governments at other levels. Usually there is a considerable flow of monies between any one government and other governments. It is important that these intergovernmental transactions be identified — and, in addition, categorized — for three reasons. First, a government must at all times have a clear view of its own operations and of its relationships with other governments, and, especially, it must present this view clearly in its reports. Second, these intergovernmental transactions must be identified by all governments so that the complex web of financial relationships between governments is apparent and available for analysis. Third, these transactions must be identified to permit proper aggregation of the financial data for groups and levels of governments and for the total government sector.
- 303 Intergovernmental financial transactions fall into four main categories. Any one government vis-à-vis another government may —
- (1) collect taxes for it,
 - (2) contribute to its support,
 - (3) contribute to the support of certain services it provides, and
 - (4) buy from it goods and services either for internal use and consumption or for distribution or resale.
- 304 The simplicity of the foregoing system masks real difficulties in implementing it. These difficulties arise because tradition, political or administrative convenience, and other equally justifiable influences, either alone or in combination, may indicate a particular category for a transaction; however, if the allocation is made by applying the concepts described below, the transaction may be assigned to a quite different category.
- 305 In the discussion and examples which follow, the problems of categorization are approached from the point of view of a municipality's relations with other governments; however, the same concepts apply to relations between funds and agencies within an individual government.
- 306 In addition to levying taxes to produce revenue to meet their own expenditures, most municipalities are required by law to raise monies on behalf of other

local governments. These governments, for which, in effect, municipalities act as tax levying and collection agencies, vary widely in type from province to province and from region to region within individual provinces. Those most commonly encountered are:

- (a) local school authorities;
- (b) “second tier” governments — metropolitan and regional municipalities and districts, urban communities, counties;
- (c) special-purpose authorities — regional libraries, conservation authorities and many others.

307 Municipalities also make “contributions” of monies to other local governments. While such contributions, which are made from the municipalities’ own revenues, are conceptually distinct from transmissions of monies raised specifically on behalf of other local governments, in practice it is often difficult to draw a clear distinction between these two types of transaction. Frequently, a municipality is required to transmit to another local government specific amounts of money regardless of whether or not the tax imposed by the municipality to raise these amounts has been collected at the time of transmission or, indeed, is ever collected. Thus the municipality may be required to supplement its collections for other local governments, temporarily or permanently, with amounts which it has collected for its own purposes, i.e. with amounts from its own revenues. Conversely, collections may exceed requirements, in which cases the surplus amounts are usually available for the municipality’s own purposes either temporarily or permanently. In the latter case such surpluses are properly classified as revenue of the municipality.

308 While, therefore, it is most desirable that receipts and disbursements of monies collected by a municipality for other governments should not be classified as revenues (or expenditures) of the municipality and should be excluded from its statement of revenue and expenditure, difficulties of segregation of such monies and of variations in amounts and timing between collection and transmission may require the inclusion of these monies in the appropriate revenue classifications of the municipality and their classification as unconditional or conditional transfers in its expenditures. The treatment to be accorded such transfers is described in the following paragraphs.

309 Provincial and territorial governments normally make grants for the general support of local governments and without any conditions attached as to the uses to which such grants are to be put. Such grants, which are true transfers in the economic sense of the term, are, however, rare between local governments. The category “Unconditional transfers” covers only those intergovernmental transactions in which the transferor does not specify any particular use to which the monies are to be put, in which the monies so transferred form part of the general revenue of the

transferor, and in which the transferee has discretion over the use of the monies. A transfer to be used for a specific purpose or purposes is a conditional transfer; therefore, a transfer made to a government which discharges only one or part of one of any of the six basic functions defined in Paragraph 273 above, is a conditional transfer, since it can only be used for a specific purpose. On the other hand, a transfer made from monies raised expressly for the purpose of making it is, as already stated, a “Transmission of taxes”.

310 Cases do arise where transfers from the general revenue of one government are made to another government which discharges more than one of the basic functions and where the exact purpose for which the transfer is to be used or the exact division between a number of purposes cannot be ascertained by the transferor. Since the conditions cannot be determined, such transfers should be categorized as “Unconditional”.

311 As stated in Paragraph 309 above, “Conditional transfers” are made from the general revenues of the transferring government and must be used by the receiving government for a specific purpose or purposes — either because the statute, regulation, or agreement authorizing the transfer so stipulates, or because the receiving government discharges only one (or part of one) of the basic functions as defined in Paragraph 273 above. In addition, the specific purpose or purposes must not involve the provision of a service to the citizens or territory of the transferring government which that government is itself authorized to provide. Transactions involving the provision of such a service on behalf of the transferring government are to be classified as Purchases of Services.

312 The criterion mentioned in the preceding paragraph for distinguishing “Conditional transfers” from “Purchases of services” may be difficult to apply. There are many cases where the service supplied by the receiving government as the condition of the transfer is related to, or complements, a service provided by the transferring government.

313 For instance, a municipality, which operates its own library, may transfer monies to a regional library which, in turn, complements the services provided by the municipal and other local libraries by bulk purchasing, cataloguing, arranging inter-library loans and so forth. This type of arrangement is in the nature of a joint undertaking and, while it might be argued that a service is indeed provided, it is recommended that contributions to joint undertakings such as this be classified as conditional transfers.

314 There are many instances where a municipality, rather than provide, from its own resources, a particular service which is within its own ambit of responsibility, will purchase this service from another government. The purchasing municipality then consumes the

service itself in carrying on its own functions, or it distributes it or resells it to parts or all of its own citizens or territory.

- 315 A typical example is the purchase of police services by a municipality from the provincial or federal police forces. This, as a purchase of service transaction, is to be clearly distinguished from the situation where a metropolitan police force polices the entire metropolitan area, policing having been established by statute as a responsibility of the metropolitan government. In this latter case, the costs to one of the constituent municipalities of policing its territory would normally be reflected in the taxes which it collects for the metropolitan government, either specifically for police services or included in the general metro tax levy; the constituent municipality would, of course, classify these taxes as collections for other governments as indicated in Paragraphs 255 and 306.

Section G. Records and Reports

- 401 The kind of information to be provided relative to any activity has considerable influence on the way in which information is acquired, stored, retrieved, and presented. However, municipal governments vary so greatly in size, and in type and scale of activity, while the range of user requirements for financial information is so wide that no generalized system of information acquisition, storage, retrieval, and presentation appears feasible at present.
- 402 The Classification Systems depict municipal government financial information in the form of standardized building blocks. In selecting the building blocks most appropriate for its own system of information recording and reporting a municipal government will be guided by the needs of its own management, of the provincial or territorial government, of the public, and of the national users of its information. The information requirements of management and the provincial and territorial governments are individualistic and categorical. The proforma statements in the supplement to Volume II of this publication, therefore, are concerned mainly with identifying national information requirements since these appear to encompass those of the public.
- 403 Generally, national information requirements cover information identified at the second level of

each of the Classification Systems. However, because information required for national purposes from a single municipal government has, in many cases, to be fitted together with, or otherwise related to, that from other local governments, from other levels of government, and from other sectors of the economy, much finer detail is required in certain areas, such as inter-governmental transactions, to ensure proper consolidation and aggregation. Additional detail is also required where municipal government activities are significant in sensitive parts of the economy such as construction, borrowing, and financial investment.

- 404 Two other points have to be considered in the design of municipal government information recording and reporting systems. First, most users now require information at relatively short time intervals. These intervals range from quarterly, for many national purposes, to weekly or even daily for some management requirements. Thus the bulk of information requirements must be met by interim reports and special compilations rather than by formal annual reports. While EDP is particularly suited to this form of reporting, there are effective manual or machine systems of information retrieval where cost or other factors preclude the use of computers.
- 405 Second, because information from any one municipal government will be consolidated in many cases with that from other local governments, from other levels of government, and from non-governmental sources, all information supplied to users outside the individual municipal government should be reported "gross". This recommendation was contained in previous DBS manuals but certain exceptions were made. For example when a municipality performed work for an individual only the excess of monies recovered over the municipality's costs were to be classified as revenue; the costs recovered were to be netted against the municipality's expenditures. The new recommendation against any form of "netting" (with one or two specific but minor exceptions) prior to reporting arises from the need to ensure that all necessary information required for valid aggregation and consolidation is available. There is the further consideration that "netting" may become a very complex procedure when the Object Classification System is used. Of course, the foregoing does not preclude "netting" in actual reports provided that the gross amount and the deductions therefrom are shown in addition to the net.

APPENDIX

Fund Accounting — Statements by Departments of Municipal Affairs

British Columbia

In view of the statutory requirements contained in the municipal Act of British Columbia and the existence of financial obligations in the form of debenture and other term indebtedness, it is essential that municipalities within the province adopt the concept of fund accounting in the following areas:

- Capital and loan funds
- Revenue funds
- Sinking funds
- Debt repayment funds
- Tax-sale properties reserve fund
- Reserve funds for specific purposes
- Trust funds
- Agency funds

It should be noted that where a municipality operates a utility, such as a water distribution system or a transportation system, it is required that separate position and operating statements, i.e. capital and loan fund and revenue fund, be prepared and filed with the department to determine whether the system is operating on a self-liquidating basis.

Manitoba

Municipal accounting is recording a story of various activities which are separate units of a whole. The whole is the municipality, but the units are of a great variety of special activities. The following is a list to illustrate "units":

1. The ordinary operating department which collects the taxes and supplies the ordinary services to the inhabitants of the municipal area — the revenue (operating) fund.
2. The department which goes to the public to borrow money for major construction purposes under term of repayment over a period of years, with interest — the capital fund.
3. The departments which operate public services:
 - (a) Waterworks fund
 - (b) Sewer fund
 - (c) Electric power fund
 - (d) Gas distribution fund
 - (e) Transportation (bus or streetcar) fund
4. The undertaking to construct improved roads, oil streets, hard surface roads, construct sidewalks or other local improvements in a certain specifically defined area — a local improvement fund.
5. The appropriation of moneys by setting them aside for a specific purpose (such as the purchase of machinery) or as savings held apart for investment — reserve funds.

The recording of the financial history of these various phases of municipal undertaking is called fund accounting.

One pertinent reason for the divisions of municipal finance into various units or funds is the requirement of the

statute. The municipal corporation receives its authority from the province of which it is a part. The municipal council have that authority to conduct the business of the corporation which has been delegated by the province. If the statute imposes limitations upon council, accounting routines must take these limitations into consideration when recording the financial story.

Following are the funds most common to Manitoba municipalities:

- General (operating) fund
- Reserve funds
- Capital and deferred funds
- Trust funds
- Utility:
 - Operating (revenue) fund
 - Reserve funds
 - Capital fund

Ontario

Separate funds are used in local government accounting in order to show that money has been used for the purpose for which it was obtained, and not for some other purpose. Much of the money which is administered by a municipality or one of its local boards has been received or set aside for a particular use. Legal restrictions or contractual agreements prevent it from being diverted to any other use.

The funds most commonly used in local government accounting appear under the names — **capital fund**, **reserve fund**, **trust fund** and **revenue fund** (also known as the **general fund**).

The **capital fund** is used to account for all capital expenditure and the financing of capital expenditure. Sources of capital financing include long term borrowing, money contributed by senior governments to assist with capital projects, and money raised for capital expenditure through current taxation, among others. In addition, the **Capital fund** is used to account for any money that is borrowed by a municipality on behalf of a local board (such as a public utility) which itself lacks the power to borrow long term.

A **reserve fund** is established to account for assets which have been segregated for a specific purpose, either voluntarily or because of legal or contractual reasons. As an illustration: contractual agreements with subdivision developers under which the municipality has received money to provide for the installation of water and sewage services will give rise to reserve funds. Other reserve funds result from decisions of a municipal council or one of its local boards to voluntarily set aside money to finance a capital project.

A **trust fund** or an Endowment fund is used in local government accounting in much the same way as it is used by hospitals, universities or charitable organizations.

The **revenue fund** (also known as the General fund) is used to account for all revenues and resources which are not otherwise accounted for separately. Revenues which are unrestricted in use, such as the general taxation revenue of a municipality, are found in the Revenue Fund. In addition, some revenues which are restricted in use but which are not usually segregated and separately accounted for may be found there. Examples of such revenues: taxes raised by a municipality on behalf of a school board, and local improvement taxes which are raised only from the taxpayers in a specified area of a municipality.

Prince Edward Island

There is no mandatory requirement for fund accounting in Prince Edward Island; however, the Prince Edward Island Public Utilities Commission requires that publicly-owned water and sewer utilities be self-supporting. This naturally results in fund accounting being practised in utility management. The town of Summerside operates the only municipally-owned electrical utility in a similar manner.

Several of the municipalities choose fund accounting for various municipal services and facilities, i.e. fire departments, recreation centres, ice arenas, etc.

Quebec

Municipal accounting, in the Province of Quebec, includes four types of funds:

1. Loan funds
2. Statutory funds
3. Operating funds
4. Public utility or enterprise funds

The loan fund. — The loan fund is used when a municipality has one or several borrowing by-laws approved and in force; this fund accounts for activities authorized or transactions made under such by-laws.

This fund is by definition provisional since it may be closed when the surplus or the deficit has been accounted for legally. It is obvious, of course, that large cities, or fast growing smaller centres, will have to maintain a loan fund on a permanent basis, since they will always have loans outstanding.

Statutory funds. — Under present legislation, municipalities authorized to set up industrial or working capital funds must keep separate accounts for these funds. Similarly, some sinking funds are required by statute or by contract.

The operating fund. — All municipalities must maintain an operating fund for recording transactions resulting from their ordinary activities.

Public utility and enterprise funds. — Such funds are permitted and their use is left to the discretion of the municipalities; there are four types of such funds:

- (a) **Public utility funds:** to be used when a municipality wishes to keep separate books for a major public utility. This is often the case for water supply and sewer systems in rural areas, where such services may constitute the main municipal activity and absorb 50% or more of

expected revenue and budgeted expenses. It is also used in the case of inter-municipal water supply and sewer systems controlled by a single municipality;

- (b) **Para-municipal enterprises:** enterprises that are often commercial or semi-commercial, and that do not really form part of the normal responsibilities of a municipality, such as the distribution of electricity or the operation of a telephone system;
- (c) **Municipal enterprises:** functions that are municipal in nature, but for which the council has delegated part of its administrative authority, for instance to a recreation commission, an exhibition commission, a harbour or airport commission, etc.;
- (d) **Special funds:** these are trust funds, cash donations or gifts in kind which must be used for specific purposes.

Modern accounting techniques appear to allow enough separation and clarity in accounts to do without most public utility and enterprise accounts; current policy is therefore to encourage municipalities to reduce the number of such accounts to a minimum.

Saskatchewan

The types of funds commonly used by Saskatchewan municipalities are as follows:

General funds. — These funds accommodate all transactions not assigned to other specific funds and are to be found in use by all municipalities.

Special activities and agencies funds (including institutions, utilities and enterprises). — Special activities of a municipality are those functions of municipal government (other than utilities) which have been delegated by law or by action of council to a special committee, board or commission for supervision and operation. Separate accounting funds are maintained for each special activity so that its financial condition and operation may be examined separately from other activities of the municipality. A utility is an enterprise type of operation deriving an income from rates, rents, fees or other charges that wholly or largely meet the expenditures of the operation.

Reserve funds. — The statutes permit accumulation of reserves for specific or general purposes as may be decided by council.

Trust funds. — These funds are set up to segregate the relevant transactions of a trust.

Sinking funds. — These funds are required to accumulate funds for the retirement of sinking fund debentures.

The first type is, and the second type normally is, divided further into two types of funds, i.e. the revenue fund and the capital and loan fund. The revenue fund reflects the normal day to day (current) operations of the municipality whereas the capital and loan fund essentially reflects fixed assets and the outstanding debt, either interim or long-term, to finance their cost.

The number of funds should be restricted to those necessary to fulfill legal and administrative requirements.

